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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-559

THE WESTERN AND SOUTHERN LIFE INSURANCE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 13-23) is reported at 460 F. 2d 8. The opinion of the Tax Court (Pet. App. 35-50) is reported at 55 T.C. 1036.

JURISDICTION

The judgment of the court of appeals (Pet. App. 24) was entered on May 12, 1972. A petition for rehearing *en banc* was denied on July 12, 1972. The petition for a writ of certiorari was filed on October 6, 1972. The

jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether, in determining the income of a life insurance company, the total amount of deferred and uncollected premiums must be included as assets, under Section 805(b)(4) of the Internal Revenue Code of 1954, without the adjustment petitioner claims for an amount it calls "loading on deferred and uncollected premiums."

2. Whether a life insurance company must include the total amount of deferred and uncollected premiums in its "gross amount of premiums" under Section 809(c)(1) without the deduction or offset it claims for an amount it calls "increase in loading on deferred and uncollected premiums."

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the Internal Revenue Code of 1954, Sections 804, 805, 809 and 818, as amended by the Life Insurance Company Income Tax Act of 1959,[1] and pertinent provisions of the Treasury Regulations, Sections 1.805-5 and 1.809-4, not set forth in the petition, are reproduced in the appendix to this brief, *infra*.

STATEMENT

Petitioner raises two related legal issues concerning the determination of a life insurance company's tax liability under the Life Insurance Company Income

[1] Through apparent inadvertence, the statutory provisions set forth in the petition include amendments not applicable to the years in issue.

Tax Act of 1959 (Sections 801 through 820 or Part I of Subchapter L of the Internal Revenue Code of 1954, as amended). The Act provides that the taxable income of a life insurance company includes the full amount of its "gain from operations" up to the amount of its "taxable investment income" plus one-half of any additional "gain from operations" (Section 802(b)). "Taxable investment income" and "gain from operations" are each the result of detailed calculations and are defined in Sections 804(a) and 809(b), respectively.[2]

In determining the income of a life insurance company, the calculation of "gain from operations" and of "taxable investment income" requires a determination of a life insurance company's "gross amount of premiums" during the taxable year. In calculating "gain from operations" the gross premiums constitute part of the basic figure—i.e., that comparable to "gross receipts" or "gross income" from which "gain from operations" is computed by subtracting statutorily defined deductions. In determining "taxable investment income" the gross premiums are included in the company's "assets," which control the fraction of investment income that is deemed "taxable."

The "gross annual premium" on a life insurance contract is the consideration the insured pays for a year's coverage; each premium covers an annual period beginning on the date of issuance or a subsequent anniversary date. The "net valuation premium" is the part of the "gross annual premium," computed on the basis of state required interest and mortality tables,

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[2] A description of the calculations performed in computing tax liability under the Act is contained in *United States* v. *Atlas Ins. Co.*, 381 U.S. 233.

that must be added to reserves for policyholders for each policy year. Petitioner defines the difference between the "gross annual premium" and the "net valuation premium" as the "loading." (Pet. 4-5; Pet. App. 37.) [3]

Deferred and uncollected premiums are portions of gross annual premiums on policies in force at the end of the taxable year which have not been collected, either because the gross annual premium is being paid in installments over the policy year or the premium is due but unpaid (a grace period having been provided in the policy). Where payment of part of the premium has been deferred, the premium is increased by an amount designed to compensate petitioner for the loss of interest on the deferred portion of the premium and for the added cost of servicing the account (Pet. App. 37).

Petitioner accrues its reserves on the basis of the assumption that the full annual premium is received on the anniversary date of every policy in force, whether or not the full premium has been paid as of that date (Pet. App. 15, 38). This method of calculating reserves increases the reserves which taxpayer is entitled to deduct under Section 809(d)(2) in calculating gain from operations and also increases the reserves used in determining the policyholders' share of investment income, which under Section 804(a)(1) is excluded from tax.

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[3] Conceptually, "loading" represents long-range projections and estimates of expenses and profit for the life of the policy which are then prorated to each annual premium. There is no necessary correlation between the "loading" on a premium in a given year and the actual expenses and profit with respect to the policy in that year.

The Treasury Regulations, Sections 1.805-5(a)(4)(ii), Example (1), and 1.809-4(a)(1)(i), Appendix, *infra*, expressly require the inclusion of deferred and uncollected portions of gross premiums in the calculation of both gross premiums and assets. Petitioner claims an adjustment—i.e., a deduction or exclusion—for an amount called "loading" in determining its "gross amount of premiums" under Section 809(c)(1) and its assets under Section 805(b)(4). Essentially, petitioner would calculate its net valuation premium (i.e., the annual addition to reserves), subtract that from the gross annual premium, label the remainder "loading" and offset against the gross premiums the part of "loading" petitioner deems allocable to the deferred part of the premium. The end result is to include only the portion of the gross premium that has in fact been paid plus the portion of the deferred portion that is included in reserves.[4]

The court of appeals, reversing a divided Tax Court's approval of petitioner's contentions, held that the statute requires the inclusion in full of deferred and uncollected portions of gross annual premiums in "gross amount of premiums" and "assets" without the offsets claimed. In so concluding, the court agreed with the unanimous holdings of the three appellate courts that had heretofore considered these issues.

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[4] Petitioner follows the treatment provided on the annual statement form of the National Association of Insurance Commissioners, which petitioner must file annually in the states where it does business (Pet. App. 16). The annual statement form is intended to demonstrate the solvency of the company using purposefully stringent and conservative accounting standards (Pet. App. 22).

Franklin Life Insurance Co. v. *United States,* 399 F. 2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118; *Jefferson Standard Life Insurance Co.* v. *United States,* 408 F. 2d 842 (C.A. 4), certiorari denied, 396 U.S. 828; *Western National Life Insurance Co. of Texas* v. *Commissioner,* 432 F. 2d 298 (C.A. 5), reversing and remanding 50 T.C. 285, as modified by 51 T.C. 824.

ARGUMENT

The decision below is correct. There is no appellate conflict or any other reason for further review.

The proper treatment of deferred and uncollected premiums depends on the meaning of the statutory reference to "the gross amount of premiums" in Section 809(c)(1). Although the statute does not further define this phrase, Congress, as the courts of appeals have recognized, was aware of the accounting practices of the insurance industry under which life insurance companies in accounting for their gross premiums include the full year's premium as of the anniversary date of each policy. There is no reason to suppose that Congress thought the same assumption would not be made in defining the phrase "gross amount of premiums" as used in the statute. The basic answer to petitioner's contention that it is entitled to an adjustment or deduction for "loading" or the like is that Congress has not provided for one. Although Subchapter L of the Code is filled with detailed provisions which define a number of allowable exclusions and deductions in the computation of the income tax liabilities of life insurance companies, there is not one reference, direct or indirect, to "loading" or "increase in load-

ing." It is no less true here than in any other tax case that exclusions and deductions must have an explicit statutory basis and, as the court below recognized (Pet. App. 22-23), the absence of such a statutory provision is fatal to petitioner's claim.[5]

The defects in petitioner's position are particularly apparent with respect to the related determination of its assets. The computation of the policyholders' share exclusion, which is critical to the determination of taxable investment income under Section 804, turns on the proportionate relationship between reserves (assets held for policyholders) and total assets.[6] Petitioner accrues reserves on the premise that the full annual premium on each policy in force, including the entire deferred and uncollected portions thereof, has been received and that, accordingly, it has a full annual reserve liability with respect to each policy. While this is not true where there are deferred and uncollected premiums—the insured parties are not legally obligated to pay those premiums and petitioner has no obligation to continue coverage if they are not paid—petitioner nevertheless uses this assumption in accruing reserves

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[5] Petitioner, of course, receives deductions under Section 809(d) for all actual insurance expenses in the years incurred. The "loading" adjustment sought is independent of those deductions.

[6] In simple form the formula may be expressed as follows:

$$\frac{\text{Investment yield}}{\text{Assets}} \times \text{Reserves} = \text{Policyholders' Exclusion}$$

or as

$$\frac{\text{Assets held for reserve purposes}}{\text{Total assets}} \times \text{Investment yield} = \text{Policyholders' Exclusion}$$

in the tax formula. As the appellate courts have unanimously stressed, petitioner may not accrue as a liability the full annual reserve and then, in the same fraction, not show as an asset the full amount of the annual premium that gives rise to that liability (the gross annual premium). As the Seventh Circuit observed in *Franklin Life Insurance Co.* v. *United States,* 399 F. 2d 757, 761, "[t]he gearing of the tax statute to an annual reserve requires recognition of no less than the annual premium."

2. Petitioner's reliance on the holding of the Fifth Circuit in *Liberty National Life Insurance Co.* v. *United States,* 463 F. 2d 1027, to the effect that mortgage escrow funds held in trust by a life insurance company are not its "assets", is misplaced. There the taxpayer never claimed that the escrow funds should be taken into account for any purpose in the tax formulae. The opposite is true here. Petitioner assumes that deferred and uncollected premiums are received and are, in effect, "assets" with respect to accruing reserves in the tax formulae, but then abandons that assumption in accruing total assets. The Fifth Circuit, in *Western National, supra,* has expressly rejected this dual standard of accounting for deferred and uncollected premiums and has upheld the Government's position. Its opinion in *Liberty National* dealing with the question of separate escrow funds does not purport to overrule, in any way, its *Western National* decision.

3. Petitioner concedes (Pet. 9) that, "there exists no conflict in decisions in the Circuits directly involving the issue of loading on unpaid premiums," and indeed four courts of appeal have now unanimously rejected

its position. It suggests, however, that the contrary view taken by the Tax Court should be given special weight because (Pet. 7) it "is made up of experts in the field of federal taxation." But Congress has expressly rejected this theory and has provided in Section 7482 of the Internal Revenue Code of 1954 that Tax Court decisions are entitled to no greater weight upon review than decisions of federal district courts.[7] Finally, petitioner urges that the issues involved are (Pet. 9) "universal in the life insurance industry" and that, absent guidance from this Court, life insurance companies are likely to continue litigating them. We agree that the issues are of a recurring industry-wide nature. Nevertheless, and despite some differences of opinion in the lower courts,[8] four courts of appeals have now spoken and agreed unanimously that petitioner's position is without merit. In these circumstances we submit that further review by this Court at this time is unnecessary and unwarranted.

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[7] Prior to 1948 it had been held, in *Dobson* v. *Commissioner*, 320 U.S. 489, that courts of appeal should not reverse decisions of the Tax Court where the expertise of the judges of that court might be considered to have an important bearing upon its decisions. By amendment in 1948 to Section 1141(a) of the Internal Revenue Code of 1939, Congress expressly repealed the rule of *Dobson* and made decisions of the Tax Court reviewable by courts of appeal in the same manner as decisions of the district court. See *United States* v. *Snyder Bros. Co.*, 367 F. 2d 980 (C.A. 5).

[8] See *Western National Life Insurance Co. of Texas* v. *Commissioner*, 432 F. 2d 298 (C.A. 5), reversing and remanding 50 T.C. 285, as modified by 51 T.C. 824; *United Life and Accident Insurance Co.* v. *United States*, 329 F. Supp. 765 (D. N.H.); and *Occidental Life Insurance Co.* v. *United States*, 25 A.F.T.R. 2d 796 (C.D. Calif.).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER, 1972.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Supp. II);[9]

SEC. 804 [as amended by Sec. 2(a), Life Insurance Company Income Tax Act of 1959, P.L. 86-69, 73 Stat. 112]. TAXABLE INVESTMENT INCOME.

(a) *In General.*—

(1) *Exclusion of policyholders' share of investment yield.*—The policyholders' share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received) of any life insurance company shall not be included in taxable investment income. For purposes of the preceding sentence, the policyholders' share of any item shall be that percentage obtained by dividing the policy and other contract liability requirements by the investment yield; except that if the policy and other contract liability requirements exceed the investment yield, then the policyholders' share of any item shall be 100 percent.

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[9] Section 804(a)(2) was amended effective for years beginning after December 31, 1961, by Section 3(b), Act of October 23, 1962, P.L. 87-858, 76 Stat. 1134, by striking out "equal to the sum" and inserting in lieu thereof "equal to the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss plus the sum"; similar wording was added as new subparagraph (B) to Section 809(b)(1) and (2). The years 1960-1962 were added to Section 809(d)(11) by P.L. 87-59, 75 Stat. 120, and P.L. 87-272, 78 Stat. 98.

(2) Taxable investment income defined.—For purposes of this part, the taxable investment income for any taxable year shall be an amount (not less than zero) equal to the sum of the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received), reduced by—

(A) the sum of—

(i) the life insurance company's share of interest which under section 103 is excluded from gross income,

(ii) the deduction for partially tax-exempt interest provided by section 242 (as modified by paragraph (3)) computed with respect to the life insurance company's share of such interest, and

(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by paragraph (5)) computed with respect to the life insurance company's share of the dividends received; and

(B) the small business deduction provided by paragraph (4).

For purposes of the preceding sentence, the life insurance company's share of any item shall be that percentage which, when added to the percentage obtained under the second sentence of paragraph (1), equals 100 percent.

(3) *Partially tax-exempt interest.*—For pur-

poses of this part, the deduction allowed by section 242 shall be an amount which bears the same ratio to the amount determined under such section without regard to this paragraph as (A) the normal tax rate for the taxable year prescribed by section 11, bears to (B) the sum of the normal tax rate and the surtax rate for the taxable year prescribed by section 11.

(4) *Small business deduction.*—For purposes of this part, the small business deduction is an amount equal to 10 percent of the investment yield for the taxable year. The deduction under this paragraph shall not exceed $25,000.

(5) *Application of section 246(b).*—In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of this subsection, the limit on the aggregate amount of the deductions allowed by sections 243(a), 244, and 245 shall be 85 percent of the taxable investment income computed without regard to the deductions allowed by such sections.

(6) *Exception.*—If it is established in any case that the application of the definition of taxable investment income contained in paragraph (2) results in the imposition of tax on—

(A) any interest which under section 103 is excluded from gross income,

(B) any amount of interest which under section 242 (as modified by paragraph (3)) is allowable as a deduction, or

(C) any amount of dividends received which under sections 243, 244, and 245 (as modified by paragraph (5)) is allowable as a deduction,

adjustment shall be made to the extent necessary to prevent such imposition.

(b) *Gross Investment Income.*—For purposes of this part, the term "gross investment income" means the sum of the following:

(1) *Interest, etc.*—The gross amount of income from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties, and

(C) the alteration or termination of any instrument or agreement described in subparagraph (B).

(2) *Short-term capital gain.*—In the case of a taxable year beginning after December 31, 1958, the amount (if any) by which the net short-term capital gain exceeds the net long-term capital loss.

(3) *Trade or business income.*—The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

Except as provided in paragraph (2), in computing

gross investment income under this subsection, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

(c) *Investment Yield Defined.*—For purposes of this part, the term "investment yield" means the gross investment income less the following deductions—

(1) *Investment expenses.*—Investment expenses for the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed the sum of—

(A) one-fourth of one percent of the mean of the assets (as defined in section 805(b)(4)) held at the beginning and end of the taxable year,

(B) the amount of the mortgage service fees for the taxable year, plus

(C) whichever of the following is the greater:

(i) one-fourth of the amount by which the investment yield (computed without any deduction for investment expenses allowed by this paragraph) exceeds 3¾ percent of the mean of the assets (as defined in section 805 (b)(4)) held at the beginning and end of the taxable year, reduced by the amount described in subparagraph (B), or

(ii) one-fourth of one percent of the mean of the value of mortgages held at the beginning and end of the taxable year for which

there are no mortgage service fees for the taxable year.

(2) *Real estate expenses.*—The amount of taxes (as provided in section 164), and other expenses, for the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(3) *Depreciation.*—The deduction allowed by section 167. The deduction under this paragraph and paragraph (2) on account of any real estate owned and occupied for insurance purposes in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this sentence) as the rental value of the space not so occupied bears to the rental value of the entire property.

(4) *Depletion.*—The deduction allowed by section 611 (relating to depletion).

(5) *Trade or business deductions.*—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner; except that in computing the deduction under this paragraph—

(A) There shall be excluded losses—

(i) from (or considered as from) sales or exchanges of capital assets,

(ii) from sales or exchanges of property used in the trade or business (as defined in section 1231(b)), and

(iii) from the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business (as so defined).

(B) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account.

(C) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII of subchapter B, shall not be allowed.

SEC. 805 [as amended by Sec. 2(a), Life Insurance Company Income Tax Act of 1959, *supra*]. POLICY AND OTHER CONTRACT LIABILITY REQUIREMENTS.

(a) *In General.*—For purposes of this part, the term "policy and other contract liability requirements" means, for any taxable year, the sum of—

(1) the adjusted life insurance reserves, multiplied by the adjusted reserves rate,

(2) the mean of the pension plan reserves at the beginning and end of the taxable year, multiplied by the current earnings rate, and

(3) the interest paid.

(b) *Adjusted Reserves Rate and Earnings Rates.*—

(1) *Adjusted reserves rate.*—For purposes of this part, the adjusted reserves rate for any taxable year is the average earnings rate or, if lower, the current earnings rate.

(2) *Current earnings rate.*—For purposes of this part, the current earnings rate for any taxable year is the amout determined by dividing—

(A) the taxpayer's investment yield for such taxable year, by

(B) the mean of the taxpayer's assets at the beginning and end of the taxable year.

(3) *Average earnings rate.*—

(A) *In general.*—For purposes of this part, the average earnings rate for any taxable year is the average of the current earnings rates for such taxable year and for each of the 4 taxable years immediately preceding such taxable year (excluding any of such 4 taxable years for which the taxpayer was not an insurance company).

(B) *Special rules.*—For purposes of subparagraph (A)—

(i) the current earnings rate for any taxable year beginning before January 1, 1958, shall be determined as if this part (as in effect for 1958) and section 381(c)(22) applied to such taxable year, and

(ii) the current earnings rate for any taxable year of any company which, for such year, is an insurance company (but not a life insurance company) shall be determined as if this part applied to such company for such year.

(4) *Assets.*—For purposes of this part, the term "assets" means all assets of the company (including non-admitted assets), other than real and personal property (excluding money) used by it in carrying on an insurance trade or business. For purposes of this paragraph, the amount attributable to—

(A) real property and stock shall be the fair market value thereof, and

(B) any other asset shall be the adjusted basis (determined without regard to fair market value on December 31, 1958) of such asset for purposes of determining gain on sale or other disposition.

(c) *Adjusted Life Insurance Reserves.*—

(1) *Adjusted life insurance reserves defined.*—For purposes of this part, the term "adjusted life insurance reserves" means—

(A) the mean of the life insurance reserves (as defined in section 801(b)), other than pension plan reserves, at the beginning and end of the taxable year, multiplied by

(B) that percentage which equals 100 percent—

(i) increased by that percentage which is 10 times the average rate of interest assumed by the taxpayer in calculating such reserves, and

(ii) reduced by that percentage which is 10 times the adjusted reserves rate.

(2) *Average interest rate assumed.*—For purposes of this part, the average rate of interest assumed in calculating reserves shall be computed—

(A) by multiplying each assumed rate of interest by the means of the amounts of such reserves computed at that rate at the beginning and end of the taxable year, and

(B) by dividing (i) the sum of the products ascertained under subparagraph (A), by (ii) the mean of the total of such reserves at the beginning and end of the taxable year.

* * * * *

SEC. 809 [as amended by Sec. 2(a), Life Insurance Company Income Tax Act of 1959, *supra*]. IN GENERAL.

(a) *Exclusion of Share of Investment Yield Set Aside for Policyholders.*—

(1) *Amount.*—The share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received) of any life insurance company set aside for policyholders shall not be included in gain or loss from operations. For purposes of the preced-

ing sentence, the share of any item set aside for policyholders shall be that percentage obtained by dividing the required interest by the investment yield; except that if the required interest exceeds the investment yield, then the share of any item set aside for policyholders shall be 100 percent.

(2) *Required interest.*—For purposes of this part, the required interest for any taxable year is the sum of the products obtained by multiplying—

(A) each rate of interest required, or assumed by the taxpayer, in calculating the reserves described in section 810(c), by

(B) the means of the amount of such reserves computed at that rate at the beginning and end of the taxable year.

(b) *Gain and Loss From Operations.*—

(1) *Gain from operations defined.*—For purposes of this part, the term "gain from operations" means the amount by which the sum of the following exceeds the deductions provided by subsection (d):

(A) the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received); and

(B) the sum of the items referred to in subsection (c).

(2) *Loss from operations defined.*—For purposes of this part, the term "loss from operations"

means the amount by which the sum of the deductions provided by subsection (d) exceeds the sum of—

(A) the life insurance company's share of each and every item of investment yield (including tax-exempt interest, partially tax-exempt interest, and dividends received); and

(B) the sum of the items referred to in subsection (c).

(3) *Life insurance company's share.*—For purposes of this subpart, the life insurance company's share of any item shall be that percentage which, when added to the percentage obtained under the second sentence of subsection (a)(1), equals 100 percent.

(4) *Exception.*—If it is established in any case that the application of the definition of gain from operations contained in paragraph (1) results in the imposition of tax on—

(A) any interest which under section 103 is excluded from gross income,

(B) any amount of interest which under section 242 (as modified by section 804(a)(3)) is allowable as a deduction, or

(C) any amount of dividends received which under sections 243, 244, and 245 (as modified by subsection (d)(8)(B)) is allowable as a deduction,

adjustment shall be made to the extent necessary to prevent such imposition.

(c) *Gross Amount.*—For purposes of subsections (b)(1) and (2), the following items shall be taken into account:

(1) *Premiums.*—The gross amount of premiums and other consideration (including advance premiums, deposits, fees, assessments, and consideration in respect of assuming liabilities under contracts not issued by the taxpayer) on insurance and annuity contracts (including contracts supplementary thereto); less return premiums, and premiums and other consideration arising out of reinsurance ceded. Except in the case of amounts of premiums or other consideration returned to another life insurance company in respect of reinsurance ceded, amounts returned where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums.

(2) *Decreases in certain reserves.*—Each net decrease in reserves which is required by section 810 or 811(b)(2) to be taken into account for purposes of this paragraph.

(3) *Other amounts.*—All amounts, not included in computing investment yield and not includible under paragraph (1) or (2), which under this subtitle are includible in gross income.

Except as included in computing investment yield, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

(d) *Deductions.*—For purposes of subsections (b)(1) and (2), there shall be allowed the following deductions:

(1) *Death benefits, etc.*—All claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts (including contracts supplementary thereto).

(2) *Increases in certain reserves.*—The net increase in reserves which is required by section 810 to be taken into account for purposes of this paragraph.

(3) *Dividends to policyholders.*—The deduction for dividends to policyholders (determined under section 811(b)).

(4) *Operations loss deduction.*—The operations loss deduction (determined under section 812).

(5) *Certain nonparticipating contracts.*—An amount equal to 10 percent of the increase for the taxable year in the reserves for nonparticipating contracts or (if greater) an amount equal to 3 percent of the premiums for the taxable year (excluding that portion of the premiums which is allocable to annuity features) attributable to nonparticipating contracts (other than group contracts) which are issued or renewed for periods of 5 years or more. For purposes of this paragraph, the term "reserves for nonparticipating contracts" means such part of the life insurance reserves (excluding that portion of the reserves which is allocable to annuity features) as relates to nonparticipating

contracts (other than group contracts). For purposes of this paragraph and paragraph (6), the term "premiums" means the net amount of the premiums and other consideration taken into account under subsection (c)(1).

(6) *Group life, accident, and health insurance.*—An amount equal to 2 percent of the premiums for the taxable year attributable to group life insurance contracts and group accident and health insurance contracts. The deduction under this paragraph for the taxable year and all preceding taxable years shall not exceed an amount equal to 50 percent of the premiums for the taxable year attributable to such contracts.

(7) *Assumption by another person of liabilities under insurance, etc., contracts.*—The consideration (other than consideration arising out of reinsurance ceded) in respect of the assumption by another person of liabilities under insurance and annuity contracts (including contracts supplementary thereto).

(8) *Tax-exempt interest, dividends, etc.*—

(A) *Life insurance company's share.*—Each of the following items:

(i) the life insurance company's share of interest which under section 103 is excluded from gross income,

(ii) the deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3)) computed with respect

to the life insurance company's share of such interest, and

(iii) the deductions for dividends received provided by sections 243, 244, and 245 (as modified by subparagraph (B)) computed with respect to the life insurance company's share of the dividends received.

(B) *Application of section 246(b).*—In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of subparagraph (A)(iii), the limit on the aggregate amount of the deductions allowed by sections 243(a), 244, and 245 shall be 85 percent of the gain from operations computed without regard to—

(i) the deductions provided by paragraphs (3), (5), and (6) of this subsection,

(ii) the operations loss deduction provided by section 812, and

(iii) the deductions allowed by sections 243(a), 244, and 245,

but such limit shall not apply for any taxable year for which there is a loss from operations.

(9) *Investment expenses, etc.*—Investment expenses to the extent not allowed as a deduction under section 804(c)(1) in computing investment yield, and the amount (if any) by which the sum of the deductions allowable under section 804(c) exceeds the gross investment income.

(10) *Small business deduction.*—A small busi-

ness deduction in an amount equal to the amount determined under section 804(a)(4).

(11) *Certain mutualization distribution.*—The amount of distributions to shareholders made in 1958 and 1959 in acquisition of stock pursuant to a plan of mutualization adopted before January 1, 1958.

(12) *Other deductions.*—Subject to the modifications provided by subsection (e), all other deductions allowed under this subtitle for purposes of computing taxable income to the extent not allowed as deductions in computing investment yield.

Except as provided in paragraph (3), no amount shall be allowed as a deduction under this subsection in respect of dividends to policyholers.

* * * * *

SEC. 818 [as amended by Sec. 2(a), Life Insurance Company Income Tax Act of 1959, *supra*]. ACCOUNTING PROVISIONS.

(a) *Method of Accounting.*—All computations entering into the determination of the taxes imposed by this part shall be made—

(1) under an accrual method of accounting, or

(2) to the extent permitted under regulations prescribed by the Secretary or his delegate, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).

Except as provided in the preceding sentence, all

such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

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Treasury Regulations on Income Tax (26 C.F.R.):

Sec. 1.805-5 *Adjusted reserves rate and earnings rates.*

(a) *In general.** * *

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(4) *Assets*—* * *

* * * * *

(ii) *Illustration of principles.** * *

Example (*1*). Included in the statement of assets of P, a life insurance company, are the following items: Bonds, stocks, mortgages, home office and branch office buildings owned and wholly occupied by the company, furniture and equipment owned by the company and used in the home office and branch office buildings occupied by the company, agents' debit balances, premiums deferred and uncollected and premiums due and unpaid, bank deposits (including time deposits), and share accounts in savings and loan associations.* * *

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Sec. 1.809-4 *Gross amount.*

(a) *Items taken into account.* For purposes of determining gain or loss from operations under section 809(b)(1) and (2), respectively, section

809(c) specifies three categories of items which shall be taken into account. * * * The * * * three * * * items taken into account are:

(1) *Premiums.* (i) * * * The term "gross amount of all premiums" means the premiums and other consideration provided in the insurance or annuity contract. * * * Such term includes advance premiums, premiums deferred and uncollected and premiums due and unpaid, * * *

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